Supreme Court, U.S.
FILED
951784 APR 24 1996
OFFICE OF THE CLERK

No.

In The

# Supreme Court of the United States

October Term, 1995

DAVID A. KOSS; FREYA B. KOSS,

*Petitioners,*

*vs.*

UNITED STATES OF AMERICA,

*Respondent.*

*Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit*

## PETITION FOR WRIT OF CERTIORARI

DAVID A. KOSS, *Pro Se*
FREYA B. KOSS, *Pro Se*
300 East Lancaster Avenue
Suite 202
Wynnewood, Pennsylvania 19096
(610) 642-2025

8634
Lutz Appellate Services, Inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

## QUESTIONS PRESENTED FOR REVIEW

1. Did the petitioners, who received shares of stock in 1974 as a fee, which shares became worthless in 1977 and the basis of which shares to the petitioners in 1974 was not finally determined by the United States Tax Court until 1990, meet all of the prerequisite conditions required by §§ 1311 through 1313 of the Internal Revenue Code of 1986 (26 U.S.C.) so as to allow the petitioners to mitigate the effect of the statute of limitations and other rules of law and thus correct their error of nonrecognition of loss in the year 1977 and adjust their tax liability for the year 1974, in the amounts and in the manner specified in § 1314 of the Internal Revenue Code?

2. Did the United States Court of Appeals for the Third Circuit misinterpret the provisions of § 1312(7)(A) of the Internal Revenue Code by concluding that the only transaction on which basis of property depends and in which transaction the error permitted to be corrected must occur, is the transaction in which the property was acquired?

3. Did the United States Court of Appeals for the Third Circuit misinterpret the provisions of § 1311(b)(1) of the Internal Revenue Code by concluding that because the petitioners failed to declare any loss whatever on their 1977 tax return due to the worthlessness of the stock and therefore the Internal Revenue Service had no notice of the loss, there was no inconsistency between the position maintained by the Internal Revenue Service and adopted by the Tax Court in 1990 that the stock had a basis of $110,000 and the erroneous nonrecogntion of loss by petitioners on their 1977 tax return in the same amount?

4. Is a taxpayer who meets the conditions of §§ 1311 through 1314 of the Internal Revenue Code entitled to the benefit of the

mitigation provisions of such sections, notwithstanding that the taxpayer has not paid the deficiency determined to be due by the Tax Court in the determination proceeding?



## TABLE OF CONTENTS


| | Page |
|---|---|
| Questions Presented for Review | i |
| Table of Contents | iii |
| Table of Citations | iv |
| Opinions Below | 1 |
| Statement of Jurisdiction | 1 |
| Statutes Involved | 1 |
| Statement of the Case | 2 |
| Reasons for Granting the Writ | 5 |
| I. Certiorari should be granted because there exists conflict among the Circuit Courts of Appeals in the interpretation of § 1312(7)(A) of the Internal Revenue Code of 1986, which conflict has resulted in conflicts in decisions among the circuit courts. | 5 |
| II. Certiorari should be granted because conflict exists among the Circuit Courts of Appeals in the interpretation of § 1311(b)(1) of the Internal Revenue Code of 1986, which conflict has resulted in conflicts in decisions among the circuit courts. | 8 |

Page

III. Certiorari should be granted because the questions raised in the instant matter are of substantial importance to the public at large and are critical to the proper administration of the Internal Revenue laws. ..... 11

Conclusion ..... 11

## TABLE OF CITATIONS

**Cases Cited:**

*Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982) . 7, 9, 10

*Great Falls National Bank v. United States*, 388 F. Supp. 577 (D.C. Mont. 1975) ..... 7

*Joyce v. United States*, 361 F.2d 602 (3rd Cir. 1966) ... 9, 10

*Kappel's Estate v. Commissioner of Internal Revenue*, 615 F.2d 91 (3rd Cir. 1980) ..... 9

*Koss v. Commissioner*, 908 F.2d 962 (3rd Cir. 1990) ... 3

*O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985) ..... 5, 6, 7

*United States v. Rushlight*, 291 F.2d 508 (9th Cir. 1961) ..... 6, 7, 9



Page

**Statutes Cited:**

26 U.S.C. § 1016(a)(1) ..... 2, 7

26 U.S.C. § 1311 ..... i, 1, 3, 4

26 U.S.C. § 1311(b)(1) ..... i, 4, 8, 10

26 U.S.C. § 1312 ..... i, 1, 3, 4, 8

26 U.S.C. § 1312(7) ..... 10

26 U.S.C. § 1312(7)(A) ..... i, 4, 5, 6, 7

26 U.S.C. § 1312(7)(C)(ii) ..... 10

26 U.S.C. § 1313 ..... i, 1, 3, 4

26 U.S.C. § 1314 ..... i, 2, 3, 4

26 U.S.C. § 6511 ..... 4

26 U.S.C. § 7422 ..... 4

28 U.S.C. § 1254(1) ..... 1

28 U.S.C. § 1291 ..... 4

28 U.S.C. § 1346(a)(1) ..... 3, 4

*Contents*


*Page*

**Rule Cited:**

Supreme Court Rule 13.3 ..... 1

**APPENDIX**

Appendix A — Opinion of the United States Court of Appeals for the Third Circuit Filed November 7, 1995 ..... 1a

Appendix B — Judgment of the United States Court of Appeals for the Third Circuit Dated November 7, 1995 ..... 19a

Appendix C — Memorandum and Final Judgment of the United States District Court for the Eastern District of Pennsylvania Filed December 21, 1994 ..... 21a

Appendix D — Order Denying Petition for Rehearing of the United States Court of Appeals for the Third Circuit Dated January 25, 1996 ..... 27a

Appendix E — Relevant Statutes ..... 29a




Petitioners, David A. Koss and Freya B. Koss, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered on November 7, 1995 and the subsequent denial of the Petition for Hearing on January 25, 1996.

## OPINIONS BELOW

The opinion and judgment of the United States Court of Appeals for the Third Circuit, dated November 7, 1995, is reproduced in Appendix A, pp. 1a-18a, and is officially reported at 69 F.3d 705. The Memorandum of the United States District Court for the Eastern District of Pennsylvania at Civil Action No. 93-6965, filed on December 21, 1994, is reproduced in Appendix C, pp. 21a-25a, and is not officially reported.

## STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered on November 7, 1995. Petitioners' timely petition to the Third Circuit Court of Appeals for rehearing was denied on January 25, 1996. Title 28 U.S.C. § 1254(1) and Rule 13.3 of the United States Supreme Court Rules confer jurisdiction on this Court to review the judgment in question by writ of certiorari.

## STATUTES INVOLVED

Internal Revenue Code of 1986 (26 U.S.C.):

Section 1311 – Text set forth in Appendix E

Section 1312 – Text set forth in Appendix E

Section 1313 – Text set forth in Appendix E

Section 1314 – Text set forth in Appendix E

Section 1016(a)(1) – Text set forth in Appendix E

## STATEMENT OF THE CASE

Petitioner, David A. Koss, a member of the Pennsylvania bar since 1957, agreed with a client in 1971 to perform legal services in exchange for stock in Video Systems Corp. In 1973, a dispute between Koss and his client over the number of shares to be paid Koss escalated into a court action. In 1974, the parties reached a settlement in which Koss would receive 22,000 shares on February 1, 1974, as well as the proceeds from the intended sale of an additional 20,000 shares. The 22,000 shares were not registered under the Securities Act of 1933, so their sale to the public was restricted.

In their 1974 federal income tax return, petitioners reported the value of the 22,000 shares as $4,400 of gross ordinary income. In 1977, the Internal Revenue Service started examining the Kosses' 1974 tax return. In 1977, the 22,000 shares became worthless. While the Internal Revenue Service examination was pending, the Kosses filed a federal income tax return for 1977 which did not claim a loss sustained on the 22,000 shares of Video Systems stock received in 1974.

On December 5, 1980, the IRS asserted an income tax deficiency of $48,788.05 against the Kosses for 1974. The deficiency was attributable to the IRS placing the fair market value of the 22,000 shares of Video Systems stock at $110,000 rather than $4,400, thus increasing the ordinary income of the Kosses by $105,600. On February 28, 1981, the Kosses timely petitioned the United States Tax Court for a redetermination of this asserted deficiency. Trial took place in the Tax Court in



October, 1985. Ultimately, in September, 1989, the Tax Court adopted the position of the IRS that the shares of stock had a basis to the Kosses of $110,000; that the ordinary income of the Kosses for 1974 was increased by $105,600, being the difference between the basis as determined and the $4,400 reported by the Kosses; and, that the Kosses owed $48,788.05. The United States Court of Appeals for the Third Circuit affirmed the decision of the Tax Court without opinion. *Koss v. Commissioner,* 908 F.2d 962 (3rd Cir. 1990). The Tax Court decision became final on September 23, 1990, when the time for petitioning for certiorari expired.

On August 3, 1991, the Kosses filed an amended tax return for 1977 indicating that the 22,000 shares of Video Systems stock had become worthless. Accordingly, they requested an adjustment of their 1977 income tax liability and a refund of the $899.07 in tax they paid for that year, pursuant to the mitigation provisions of §§ 1311 through 1314 of the Internal Revenue Code of 1986. On that same date, the Kosses also filed an amended tax return for 1974 that requested an adjustment based on the carryback of the net operating loss incurred in 1977 due to the worthlessness of the 22,000 shares, pursuant to the mitigation provisions contained in section 1314 of the Internal Revenue Code. At that time, they paid a tax of $2,148.41 for 1974, which they computed was the amount due after application of the carryback loss. The IRS disallowed the requested adjustments on November 21, 1993.

On December 27, 1993, the Kosses brought this action in the United States District Court for the Eastern District of Pennsylvania pursuant to 28 U.S.C. § 1346(a)(1) for recovery of the $899.07 and for allowance of the requested adjustment on their 1974 tax return. The district court entered summary judgment in favor of the government on December 21, 1994. It concluded that the complaint was barred by the statute of

limitations contained in 26 U.S.C. § 6511 and could not be salvaged by the mitigation provisions of §§ 1311-14 of the Internal Revenue Code. The district court reasoned that because the Kosses had taken no loss whatever on their 1977 tax return due to the worthlessness of the stock, the IRS did not take any position as to the loss by its acceptance of the 1977 tax return; and thus, the requirement of inconsistency as contained in § 1311(b)(1) of the Internal Revenue Code was not met.

The Kosses then timely appealed to the United States Court of Appeals for the Third Circuit pursuant to 28 U.S.C. § 1291, asserting that the district court had jurisdiction under 28 U.S.C. § 1346(a)(1) and 26 U.S.C. § 7422. The court of appeals affirmed the decision of the district court on the same ground and further, on the ground that the Kosses had not met the circumstance of adjustment required by § 1312(7)(A) of the Internal Revenue Code, in that the loss incurred by the Kosses due to the worthlessness of the stock did not occur in a transaction on which basis depends. The court of appeals concluded that the only transaction on which basis depends is the transaction in which the stock is acquired and only an error which occurs in that acquisition transaction may be corrected under the provisions of §§ 1311-14 of the Internal Revenue Code.

Petitioners' petition for rehearing was denied by the court of appeals on January 25, 1996.



## REASONS FOR GRANTING THE WRIT

### I.

### CERTIORARI SHOULD BE GRANTED BECAUSE THERE EXISTS CONFLICT AMONG THE CIRCUIT COURTS OF APPEALS IN THE INTERPRETATION OF § 1312(7)(A) OF THE INTERNAL REVENUE CODE OF 1986, WHICH CONFLICT HAS RESULTED IN CONFLICTS IN DECISIONS AMONG THE CIRCUIT COURTS.

Section 1312(7)(A) of the Internal Revenue Code of 1986 states, in part:

> The determination determines the basis of property, and in respect of any transaction on which such basis depends, . . . there occurred. . . any of the errors. . . .

26 U.S.C. § 1312(7)(A). The interpretation of these words has been the subject of conflict among the United States Courts of Appeals for many years, resulting in conflicting decisions among the circuits and with decisions of the district courts.

In a lengthy attempt to interpret these words, the Seventh Circuit Court of Appeals, in the case of *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985), concluded that the only transaction on which the basis of property depends is the transaction in which the property is acquired; that the transaction in which property is disposed of is not a transaction on which basis depends but rather a transaction which depends on basis; and, that therefore the only error which may be corrected under the provisions of § 1312(7)(A) is an error which occurs in that very acquisition transaction. (*Id.* 766 F.2d. at 1043). These

conclusions resulted in a denial of mitigation to the taxpayer because the error which the taxpayer sought to correct occurred in the disposition transaction.

In the instant matter, the Third Circuit Court of Appeals adopted the conclusions of the Seventh Circuit and thus reasoned that the mitigation provisions of § 1312(7)(A) did not apply because the Kosses sought to correct an error which occurred in the disposition transaction.

Contrary to the conclusions of the Seventh and Third Circuit Courts of Appeals, the Ninth Circuit Court of Appeals, in the case of *United States v. Rushlight*, 291 F.2d 508 (9th Cir. 1961), in interpreting the same words as contained in the predecessor of the present § 1312(7)(A), permitted mitigation where the error which the taxpayer sought to correct occurred in the disposition transaction because the disposition transaction is also a transaction on which the basis of property depends. (*Id.* 291 F.2d at 519).

Both the Seventh Circuit, in *O'Brien*, and the Third Circuit, in the instant matter, cited *Rushlight* as the basis for their conclusion that the only transaction on which basis depends is the transaction in which the property is acquired. However, in *Rushlight*, the taxpayers were seeking to obtain adjustment and correction under the mitigation provisions for two different types of errors, one of which was for depreciation on property which they had not disposed of and the other of which was for recognition of too much gain reported on assets which they had disposed of. The former adjustment and correction was denied because they had not disposed of the assets, and it was with respect to this denial that the court concluded that one of the transactions on which basis depends is the acquisition transaction and that inconsistency must exist between that transaction and the disposition transaction for the mitigation provisions to apply. *United States v. Rushlight, supra* at 516-518.



The other adjustment was allowed by the court, but the complex facts and conclusions of the *Rushlight* court were, it is submitted, misread by the Seventh Circuit and the Third Circuit, thus leading to incorrect conclusions of law by both the Seventh Circuit in *O'Brien* and the Third Circuit in the instant matter.

Also, contrary to the conclusions reached by the Seventh and Third Circuits as to the interpretation of § 1312(7)(A) of the Internal Revenue Code, the Fourth Circuit Court of Appeals, in the case of *Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982), permitted mitigation under the same facts as existed in *O'Brien*, albeit under a different rationale brought about, it is submitted, by a misinterpretation of the *Rushlight* case.

Not only does there exist conflict among the circuit courts, but conflict exists in the interpretation of the legal principles embodied in § 1312(7)(A) between district courts and the circuit courts. In *Great Falls National Bank v. United States*, 388 F. Supp. 577 (D.C. Mont. 1975), the district court allowed mitigation where the error of the taxpayer occurred in the disposition transaction before the final determination of basis occurred, as was the case in the instant matter, in *Chertkof* and in one of the instances in *Rushlight*.

It is submitted that these conflicts exist because the Seventh and Third Circuit Courts of Appeals fail to recognize that the words "in respect of" have a meaning different from the words "with respect to", which latter word phrase is used eight times in § 1312(7)(A); fail to give the word "any" its ordinary meaning; and, fail to give effect to § 1016(a)(1) of the Internal Revenue Code, which section delineates transactions which require adjustments to basis and which are therefore transactions on which basis depends.

## II.

**CERTIORARI SHOULD BE GRANTED BECAUSE CONFLICT EXISTS AMONG THE CIRCUIT COURTS OF APPEALS IN THE INTERPRETATION OF § 1311(b)(1) OF THE INTERNAL REVENUE CODE OF 1986, WHICH CONFLICT HAS RESULTED IN CONFLICTS IN DECISIONS AMONG THE CIRCUIT COURTS.**

Section 1311(b)(1) of the Internal Revenue Code of 1986 states, in part:

> . . . . an adjustment shall be made under this part only if —
>
> > (A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary, . . . .
>
> and the position maintained by the Secretary in the case described in subparagraph (A) . . . . is inconsistent with the erroneous inclusion, exclusion, allowance, disallowance, recognition, or nonrecognition, as the case may be.

26 U.S.C. § 1311(b)(1).

The interpretation of what constitutes the inconsistency required by § 1311(b)(1) has been the subject of recurring conflict among the United States Courts of Appeals, resulting in conflicting decisions among the circuits in cases involving various circumstances of adjustment set forth in § 1312 of the Internal Revenue Code.



Some courts require that the position of the Secretary in the determination proceeding must be inconsistent with an active position taken by the Secretary in the treatment of the error. Other courts require that the position of the Secretary in the determination proceeding must be inconsistent only with the taxpayer's error and need not be "active".

The United States Court of Appeals for the Third Circuit, in the case of *Kappel's Estate v. Commissioner of Internal Revenue*, 615 F.2d 91 (3rd Cir. 1980), stated, by way of dictum, that the position maintained by the Secretary in the determination proceeding must be "actively" inconsistent with its treatment of the error. In *Joyce v. United States*, 361 F.2d 602 (3rd Cir. 1966), the court denied mitigation to a taxpayer who failed to recognize a loss because the position maintained by the Commissioner in the determination proceeding was not "logically" inconsistent with the error. In *Joyce*, it is submitted that the court applied the "active" inconsistency requirement because the position maintained by the Commissioner in the determination proceeding was, contrary to the conclusion of the court, logically inconsistent with the error of the taxpayer in failing to recognize a loss.

Contrary to the holding of the Third Circuit in *Joyce* and the dictum in *Kappel*, the Ninth Circuit Court of Appeals, in *United States v. Rushlight, supra* at 518, 519, and the Fourth Circuit Court of Appeals, in *Chertkof v. United States, supra* at 994, stated that the position maintained by the Internal Revenue Service in the determination proceeding need be inconsistent only with the error of the taxpayer in order for the taxpayer to obtain an adjustment and correction of the error under the mitigation provisions. The Fourth Circuit Court of Appeals, in *Chertkof*, elaborated on the inconsistency requirement and held that acceptance of the tax return by the Internal Revenue Service, which was erroneous with respect to the errors delineated in

§ 1312(7) of the Internal Revenue Code, prior to the final determination of basis, constituted the inconsistency required by § 1311(b)(1) of the Internal Revenue Code. *Chertkof v. United States, supra* at 994.

In the instant matter, the Court of Appeals for the Third Circuit, adhering to its requirement of "active" inconsistency, concluded that because the Kosses failed to recognize any loss whatever due to the worthlessness of the stock in 1977, the Internal Revenue Service accepted the 1977 tax return without notice of the loss and therefore the IRS could not have maintained inconsistent positions. This conclusion ignores the plain words of § 1311(b)(1), which require that the position maintained by the IRS in the determination be inconsistent only with the error of the taxpayer. The error of the Kosses was the nonrecognition of loss in the amount of the basis of the stock ($110,000) as was subsequently determined by the Tax Court in 1990. Erroneous nonrecognition of loss, an error which can be corrected under § 1312(7)(C)(ii), by its very nature, implies non-disclosure of the loss to the IRS because mistakenly not reported by a taxpayer on a tax return due to lack of knowledge of the loss in the proper amount. The conclusion of the Third Circuit that acceptance of a tax return by the IRS that does not disclose the loss in any amount does not constitute the inconsistency required by § 1311(b)(1) of the Internal Revenue Code (which conclusion was reached in *Joyce v. United States, supra,* and in the instant matter), completely abrogates the plain words of § 1312(7)(C)(ii) relating to correction of an erroneous nonrecognition of loss and nullifies the intent of Congress in providing for the correction of such an error, resulting in substantial monetary harm to taxpayers.



## III.

## CERTIORARI SHOULD BE GRANTED BECAUSE THE QUESTIONS RAISED IN THE INSTANT MATTER ARE OF SUBSTANTIAL IMPORTANCE TO THE PUBLIC AT LARGE AND ARE CRITICAL TO THE PROPER ADMINISTRATION OF THE INTERNAL REVENUE LAWS.

The questions raised in the instant matter have in the past and will continue to affect the taxpaying public. The resolution of these questions will have importance far beyond the particular facts in the instant matter. The instant matter presents in one case the most controversial provisions of the mitigation sections of the Internal Revenue Code, which contoversies have, for too long, impeded the uniform administration of the Internal Revenue Code. The mitigation provisions are critical to the proper and equitable administration of the Internal Revenue laws and the conflicts and controversies relating to these provisions should be settled by this Court.

## CONCLUSION

For the reasons set forth above, Petitioners respectfully request that this Court grant the petition for writ of certiorari.

Respectfully submitted,

DAVID A. KOSS, *Pro Se*
FREYA B. KOSS, *Pro Se*
300 East Lancaster Avenue
Suite 202
Wynnewood, Pennsylvania 19096
(610) 642-2025

**APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED NOVEMBER 7, 1995**

No. 95-1154

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

DAVID A. KOSS; FREYA B. KOSS,

*Appellants*

v.

UNITED STATES OF AMERICA

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 93-06965)

Argued October 10, 1995

BEFORE: GREENBERG, LEWIS, and ROSENN,
*Circuit Judges*

(Filed: November 7, 1995)

David A. Koss (argued)
300 East Lancaster Avenue
The Wynnewood House
Wynnewood, PA 19096

*Attorney for Appellants*

*Appendix A*

Loretta C. Argett
Assistant Attorney General
Gary R. Allen
Kenneth L. Greene
Sara Ann Ketchum (argued)
Attorneys Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

Michael R. Stiles
United States Attorney
615 Chestnut Street
Philadelphia, PA 19106-4476

*Attorneys for Appellee*

## OPINION OF THE COURT

GREENBERG, *Circuit Judge.*

### I. FACTUAL & PROCEDURAL BACKGROUND

This matter is before the court on an appeal by taxpayers in a suit involving claims for income tax adjustments and refunds. The facts are not in dispute, and we set them forth as found by the district court. Appellant David A. Koss, a member of the Pennsylvania bar since 1957, agreed with a client in 1971 to perform legal services in exchange for stock in Video Systems Corp. In 1973, a dispute between Koss and his client over the number of shares to be paid Koss escalated into a court action. In January 1974, the parties reached a settlement in which Koss would receive 22,000 shares on February 1, 1974, as well as the



*Appendix A*

proceeds from the intended sale of an additional 20,000 shares. The 22,000 shares were not registered under the Securities Act of 1933, so their sale to the public was restricted.

In their 1974 federal income tax return, Koss and his wife, appellant Freya Koss, reported the value of the 22,000 shares as $4,400 of gross ordinary income. In 1977, the Internal Revenue Service started examining the Kosses' 1974 return. However, in 1977 the shares became worthless. While this examination was pending, the Kosses filed a federal income tax return for 1977 which did not claim a loss sustained on the 22,000 shares of Video Systems stock received in 1974.

On December 5, 1980, the IRS asserted an income tax deficiency of $48,788.05 against the Kosses for 1974.[1] The deficiency was attributable to the IRS placing the fair market value of the 22,000 shares of Video Systems stock at $110,000 rather than $4,400. On February 28, 1981, the Kosses timely petitioned the United States Tax Court for a redetermination of this asserted deficiency. Ultimately, the Tax Court upheld the IRS and determined that the Kosses owed $48,788.05. We affirmed the decision of the Tax Court. *Koss v. Commissioner*, 57 T.C.M. (CCH) 882 (1989), *aff'd*, 908 F.2d 962 (3d Cir. 1990). The Tax Court decision became final on September 23, 1990, when the time for petitioning for certiorari expired.

On August 3, 1991, the Kosses filed an amended tax return for 1977 indicating that the 22,000 shares of Video Systems stock had become worthless. Accordingly, they requested an adjustment of their income tax liability and a refund of the

---

1. We take this figure from the Tax Court opinion. In its brief the government indicates the figure was $47,788.05.

$899.07 in tax they paid for that year. On that same date, the Kosses also filed an amended tax return for 1974 that requested an adjustment based on the carryback of the net operating loss incurred in 1977 due to the worthlessness of the 22,000 shares. At that time, they paid a tax of $2,148.41 for 1974, which they computed was the amount due after application of the carryback loss. The IRS disallowed the requested adjustments on November 21, 1993.

On December 27, 1993, the Kosses brought this action for recovery of the $899.07 and for allowance of the requested adjustments on their 1974 return. The district court entered summary judgment in favor of the government on December 21, 1994. It reasoned that the complaint was barred by the statute of limitations in 26 U.S.C. § 6511 and could not be salvaged by the mitigation sections at 26 U.S.C. §§ 1311-14. The Kosses then timely appealed, asserting that the district court had jurisdiction under 28 U.S.C. § 1346(a)(1) (civil action against United States for recovery of tax allegedly erroneously or illegally assessed or collected) and 26 U.S.C. § 7422 (civil action for refund). We have jurisdiction pursuant to 28 U.S.C. § 1291 and exercise plenary review. *See Pleasant Summit Land Corp. v. Commissioner,* 863 F.2d 263, 268 (3d Cir. 1988), *cert. denied,* 493 U.S. 901, 110 S.Ct. 260 (1989).

## II. DISCUSSION

### A. Limitations on Jurisdiction

The United States "is immune from suit, save as it consents to be sued . . . and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit." *United States v. Testan,* 424 U.S. 392, 399, 96 S.Ct. 948, 953 (1976)



(quoting *United States v. Sherwood,* 312 U.S. 584, 586, 61 S.Ct. 767, 769 (1941)). Thus, although 28 U.S.C. § 1346(a)(1) provides that the district court has jurisdiction over "[a]ny civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected . . . under the internal-revenue laws," other statutory provisions placing requirements or restrictions on such actions limit and determine the scope of this grant of jurisdiction. *United States v. Dalm,* 494 U.S. 596, 601, 110 S.Ct. 1361, 1364 (1990).

The statute of limitations in 26 U.S.C. § 6511 is one such limitation on jurisdiction. The basic rule is as follows:

> Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later. . . .

26 U.S.C. § 6511(a). Where, however, the claim for credit or refund relates to an overpayment of income tax on account of bad debts or worthless securities, the limitations period is "7 years from the date prescribed by law for filing the return for the year with respect to which the claim is made." 26 U.S.C. § 6511(d)(1). A claim for credit or refund of tax brought after the expiration of the limitations period is outside the district court's jurisdiction. *United States v. Dalm,* 494 U.S. at 602, 110 S.Ct. at 1365.

In this case, the Kosses seek an adjustment of their 1977

income tax liability and a refund of $899.07 from the tax they paid upon filing their 1977 income tax return on or before April 15, 1978. Under section 6511(d)(1), the applicable statute of limitations expired seven years after that date, or April 15, 1985. Consequently, the refund claim filed on August 3, 1991, is barred by the statute of limitations.

Further, under 28 U.S.C. § 1346(a)(1), a taxpayer filing suit for an income tax refund must pay the full amount of the tax prior to filing the suit. Thus, in *Flora v. United States*, the Supreme Court concluded that "§ 1346(a)(1), correctly construed, requires full payment of the assessment before an income tax refund suit can be maintained in a Federal District Court." 362 U.S. 145, 177, 80 S.Ct. 630, 647 (1960); *see also Psaty v. United States*, 442 F.2d 1154, 1158 (3d Cir. 1971). This requirement defeats the Kosses' claim for an adjustment to their 1974 income tax liability. As described above, the IRS asserted a deficiency of $48,788.05 against them for 1974. The Kosses filed a petition with the Tax Court for a determination, which determination became final on September 23, 1990. Although the Kosses have not paid the deficiency of $48,788.05, they seek to adjust their tax liability for 1974 based on (1) the IRS's determination that the 22,000 shares were worth $110,000 in 1974; (2) the loss of that amount in 1977 due to the worthlessness of the stock; and (3) the carryback of the net operating loss resulting from the loss incurred in 1977. The Kosses have labelled their claim as one for an adjustment of their 1974 tax liability, but the net effect they seek is a credit to be applied to the outstanding deficiency. Because they have not paid the full amount of the asserted deficiency, however, their claim cannot be brought in the district court under 28 U.S.C. § 1346(a)(1).

As the government correctly points out, this is a no-win



argument for the Kosses. If they did not pay the full assessment for the year 1974, they could not bring the claim under 28 U.S.C. § 1346(a)(1). If they did pay it, their current claim would still be barred by the statute of limitations found in section 6511(d)(2)(A):

> If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback . . . , in lieu of the 3-year period of limitation prescribed in subsection (a), *the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss* . . . which results in such carryback. . . .

26 U.S.C. § 6511(d)(2)(A) (emphasis added). The net operating loss is alleged to have occurred in 1977; the tax return for that year was required to be filed by April 15, 1978. The Kosses filed their 1977 return on or before April 15, 1978, and thus they had three years, or until April 15, 1981, to bring this claim to adjust their 1974 tax liability. Since they did not bring the claim until 1991, it is time-barred.

Moreover, the government argues correctly that the claim to adjust the 1974 tax liability is also barred by section 6512(a), which provides:

> **Effect of petition to Tax Court.** — If the Secretary has mailed to the taxpayer a notice of deficiency under section 6212(a) (relating to deficiencies of income, estate, gift, and

> certain excise taxes) and if the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a) . . . , no credit or refund of income tax for the same taxable year . . . in respect of which the Secretary has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of the tax shall be instituted in any court. . . .

26 U.S.C. § 6512(a). Under this section, filing a petition to the Tax Court to challenge an asserted deficiency bars the taxpayer from bringing a suit in any other court for the recovery of any part of the tax for that taxable year. *See, e.g., Solitron Devices, Inc. v. United States*, 862 F.2d 846, 848 (11th Cir. 1989) (section 6512(a) bars any action for taxes for same taxable year in respect of which taxpayer petitioned Tax Court); *First Nat'l Bank v. United States*, 792 F.2d 954, 5356 (9th Cir. 1986) (district court has no jurisdiction over redetermination of estate tax liability previously established in Tax Court), *cert. denied*, 479 U.S. 1064, 107 S.Ct. 948 (1987); *Bowser v. Commissioner*, 559 F.2d 1207, No. 76-1031, 1977 WL 25925, at *1 (3d Cir. June 10, 1977) ("§ 6512(a) operates as a limitation on the general jurisdictional grant of 28 U.S.C. § 1346 [ ]"); *Elbert v. Johnson*, 164 F.2d 421, 424 (2d Cir. 1947) ("It is not the decision which the Tax Court makes but the fact that the taxpayer has resorted to that court which ends his opportunity to litigate in the District Court his tax liability for the year in question."); *see also United States v. Dalm*, 494 U.S. at 606, 110 S.Ct. at 1367 (noting that taxpayer's petition in Tax Court on income tax liability precluded relitigation of same in district court).

When the IRS notified them of the deficiency for 1974, the Kosses did not pay the tax and seek a refund in the district court.



Rather, they petitioned the Tax Court for a determination which ultimately became final against them. Consequently, they are barred by section 6512(a) from bringing any suit in any court to litigate their tax liability for 1974. We realize that when the Video Systems stock became worthless in 1977, the Kosses believed that the shares had been worth only $4,400 rather than $110,000 in 1974, and that they believe that they therefore could not have asserted a $110,000 loss in the Tax Court. Nevertheless, the fact that the Kosses are advancing issues that were not presented to the Tax Court and perhaps could not have been considered by that court cannot change our conclusion. "[T]he Tax Court's jurisdiction, once it attaches, extends to the entire subject of the correct tax for the particular year." *Erickson v. United States*, 309 F.2d 760, 767 (Cl. Ct. 1962). Even in cases where the issues raised by taxpayers in the district court could not have been litigated in the Tax Court because they arose from facts occurring after the Tax Court's decision, courts regularly hold that the petition to the Tax Court bars a subsequent suit in the district court. *See, e.g., Solitron Devices, Inc. v. United States*, 862 F.2d at 849; *United States v. Wolf*; 238 F.2d 447, 451 (9th Cir. 1956); *Elbert v. Johnson*, 164 F.2d at 424.

### B. Mitigation of Effects of Limitations

In certain instances, the effects of the statute of limitations may be mitigated.[2] 26 U.S.C. §§ 1311-14. While these mitigation provisions are remedial and should be given a liberal

---

2. Though this point is by no means clear, we will assume without deciding that, notwithstanding the Kosses failure to pay the 1974 tax assessment in full. and notwithstanding their institution of the Tax Court proceeding for that year, if the mitigation provisions were by their terms applicable here, we could apply them to grant the Kosses relief. In this regard, we note that the government's brief does not contend expressly that these procedural hurdles render the mitigation provisions inapplicable for 1974.

interpretation, the party invoking them has the burden of showing that mitigation is permitted. *O'Brien v. United States*, 766 F.2d 1038, 1042 (7th Cir. 1985) (citing *Olin Mathieson Chem. Corp. v. United States*, 265 F.2d 293, 296 (7th Cir. 1959)).

Section 1311 (a) allows for the correction of certain types of errors:

> **General rule.** — If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

26 U.S.C. § 1311(a). Section 1313 defines "determination" to include "a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final." 26 U.S.C. § 1313. The Kosses claim the Tax Court's decision to value the shares at $110,000 and the 1974 tax deficiency at $48,788.05 falls within this definition of "determination."

The Kosses contend that this determination further is described in section 1312(7)(A), which provides in relevant part:

> **(A) General rule.** — The determination



> determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

26 U.S.C. § 1312(7)(A). They further contend that the determination resulted in an error described in section 1312(7)(C)(ii):

> **(C) Prior erroneous treatment.** — With respect to a taxpayer described in subparagraph (B) of this paragraph —
>
> . . . .
>
> (ii) there was an erroneous recognition, or nonrecognition, of gain or loss. . . .

26 U.S.C. § 1312(7)(c)(ii). In particular, the Kosses argue that there was an erroneous nonrecognition of the loss of $110,000 on their 1977 return, and that this error was not rectifiable at the time of the determination due to the expiration of the statute of limitations in section 6511. Br. at 11-12.

The problem with this argument is that the error they specify was not due to the determination by the Tax Court of the 1974 basis of the shares. The nonrecognition in the 1977 return of the loss of the value of the shares was caused by the Kosses' failure

to declare that they had any loss at all. Thus, if they had declared in their 1977 return the loss of the value of securities (which they claimed to be worth $4,400), then the Tax Court's determination would have caused an error of nonrecognition of a loss of $110,000 less $4,400, or $105,600. In any event, this causal factor cannot help the Kosses, because section 1312(7)(A) does not describe an error that is caused by or is the result of a determination. *O'Brien*, 766 F.2d at 1043.

Section 1312(7)(A) requires that the error described in subparagraph (C) occur, not as a result of the determination, but "in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis." A "transaction oh which ... basis depends" refers to " 'the transaction in which the property was acquired, and the basis of the property at the time of disposition can be said to depend on [or is determined by] such transaction.' " *O'Brien*, 766 F.2d at 1043 n.5 (quoting *United States v. Rushlight*, 291 F.2d 508, 517 (9th Cir. 1961)).

In *O'Brien*, 766 F.2d 1038, the Court of Appeals for the Seventh Circuit faced similar issues. There, the taxpayer received shares of stock as a gift made in contemplation of death. The relevant estate filed an estate tax return in 1974 that valued the stock at about $215 per share. The IRS challenged this valuation, and the matter was litigated in the Tax Court. In 1975, the corporation at issue was liquidated, and the taxpayer reported the resulting capital gain on his 1975 federal income tax return predicated on a basis of $215 per share. The IRS did not dispute this 1975 return. In 1980, the Tax Court finally entered a stipulated order setting the value of the stock at about $280 per share at the time of the original owner's death. In 1981, the taxpayer filed a refund claim for the overpayment of capital



gains tax that was based on the lower basis figure, but the IRS denied the claim as untimely because more than three years had passed since the filing of the 1975 return and more than two years had passed since the taxpayer had paid the tax which he sought refunded. The taxpayer then filed a refund action in the district court and attempted to invoke the mitigation provisions involved in this case to avoid the statute of limitations bar. The Court of Appeals for the Seventh Circuit held that the mitigation provisions did not apply. Specifically, the court held that the error of overpayment of capital gains tax was not "in respect of" the transaction, which was the transfer of the shares by the taxpayer's father and his subsequent death. *Id.* at 1043. The court explained that this error occurred " 'in respect of' the 1975 liquidation transaction and did not occur 'in respect of the [father's] transfer and subsequent death." *Id.*

As the government points out, the error alleged here, the nonrecognition of loss resulting from the worthlessness of the stock in 1977, similarly was not "in respect of any transaction on which such basis depends." 26 U.S.C. § 1312(7)(A). The basis of the shares in the determination depended on the transaction in which David Koss acquired them in 1974. The basis of the shares did not depend on their becoming worthless in 1977. Thus, the error in failing to recognize the shares' loss in value did not occur "in respect of" their acquisition by David Koss in 1974.

The Kosses further argue that because the shares eventually became worthless, the basis of the shares also had to be adjusted downward according to 26 U.S.C. § 1016(a)(1) and, therefore, the loss of the value of the shares in 1977 was a transaction on which the basis of the property depended. Reply Br. at 7. We cannot accept this analysis, however, because it ignores the first part of section 1312(7)(A):

> *The determination determines the basis of property*, and in respect of any transaction on which such basis depends, . . . there occurred . . . any of the errors

26 U.S.C. § 1312(7)(A) (emphasis added). The determination did not purport to ascertain the basis of the shares for all time. It only sought to determine the basis of the shares in 1974 so that the Kosses' taxable income and tax liability for 1974 could be determined. Clearly, the basis of the shares in 1974 depends only on their value at the acquisition by the Kosses and not on the shares' subsequent loss in value in 1977. In addition, while the Kosses allege that they "reduced the basis of the Video stock in 1977 by $4,400," reply br. at 7, as required by Section 1016(a)(1), it is not clear that they did so, for they did not deduct this loss on the 1977 return, and section 1016(a)(1) refers only to a reduction in basis for losses "for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years." 26 U.S.C. § 1016(a)(1).

Finally, even if the Kosses' claim could satisfy the general rule of section 1311(a), they fail to meet the additional "[c]onditions necessary for adjustment" listed in section 1311(b). Only the condition in section 1311(b)(1) is arguably applicable in this case:

> **(1) Maintenance of an inconsistent position.** — Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if —
>
> **(A)** in case the amount of the adjustment



> would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary, or
>
> **(B)** in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made,
>
> and the position maintained by the Secretary in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

26 U.S.C. § 1311(b)(1). This condition is the heart of the mitigation provisions and serves to limit their application mostly to cases in which inconsistent tax treatment results in harsh results that cannot be rectified due to the expiration of the limitations period. *See O'Brien*, 766 F.2d at 1041.

The Kosses assert that the IRS maintained inconsistent positions by arguing in its deficiency assertion, filed in 1980 and conclusively determined in 1990, that the basis of the shares in 1974 was $110,000 while also accepting the Kosses' 1977 return (filed in 1978) which did not declare a loss of the $110,000. We do not view these acts of the IRS as inconsistent. Although it may

be true that the Kosses could not have known when filing their 1977 return that the shares were originally worth $110,000, and that they therefore had lost $110,000 in value, the fact remains that they did not declare a loss at all in their 1977 return. Consequently, the IRS accepted their 1977 return without notice that the shares were worthless. Surely, the IRS is not required to verify the value of the capital assets of all taxpayers each year to make sure they have not become worthless. Thus, its acceptance of the 1977 return that did not declare such a loss, at whatever value, is not inconsistent with its successful position in Tax Court that the shares had a basis of $110,000 to the Kosses in 1974.

The Kosses are correct in arguing that section 1311(b)(1) does not require the taxpayer to disclose the loss or the reason for the nonrecognition of loss in the return for the year of the error. Br. at 14. This claim, however, is not the issue. The issue is whether the IRS maintained inconsistent positions. The answer is that the IRS could not have maintained inconsistent positions because when the Kosses filed their 1977 return they did not declare that the shares became worthless in that year and, thus, they did not put the IRS on notice of that fact. If the shares had not been worthless in 1977, the Kosses would not have been allowed to recognize in their 1977 return any loss or gain in value of the shares unless they disposed of them. Had they done so, their 1977 return would have been the same as the one they actually filed.

In sum, the Kosses' claims are barred either by the statute of limitations or by their failure to pay the full assessed tax, and the mitigation provisions regretfully offer them no relief. These claims were thus not within the district court's jurisdiction and were dismissed properly.



### C. Equitable Recoupment

The Kosses also brought a claim for equitable recoupment to offset the loss in the value of the shares. The district court concluded that it also did not have jurisdiction to entertain the equitable recoupment claim because it did not have jurisdiction over the other timebarred claims. *Koss v. United States*, No. 93-6965, slip op. at 5 (E.D. Pa. Dec. 21, 1994). Under *United States v. Dalm*, 494 U.S. at 608-10, 110 S.Ct. at 1368-69, equitable recoupment cannot be the sole basis of jurisdiction over claims for tax credit or refund. Thus, a court can consider an equitable recoupment claim only if it has jurisdiction on other grounds.

On appeal, the Kosses argue that although the 1977 tax year may be closed irrevocably due to the statute of limitations, the 1974 tax year, which was before the Tax Court, remains open and thus could be under the jurisdiction of the district court for purposes of equitable recoupment. Br. at 18. To that end, the Kosses state that they are not seeking here "to revive an untimely affirmative refund claim," but "to offset a timely claim of the [IRS] for tax assessed" for the year 1974 relating to the stock. Br. at 19. But, as we discussed above, the Kosses' resort to the Tax Court deprived the district court of Jurisdiction over the 1974 tax year. Thus, even if the 1974 tax year remained open, it would be open only for the Tax Court and not for the district court or any other court.

## III. CONCLUSION

We cannot close this opinion without making an additional observation. It is, of course, commonplace to note that the Internal Revenue Code is remarkably complicated. In this case, these complications have cost the Kosses dearly. Indeed, at oral

*Appendix A*

argument we were told that their debt to the IRS now exceeds $300,000 because of the inclusion of interest. Yet it is very possible that, but for the operation of the non-substantive, highly technical procedural provisions that have been applied, they would not owe this money. We are disturbed by the harsh result. Perhaps the Kosses, under the unusually oppressive circumstances here, still may obtain administrative relief from the IRS, or some other authority. However, we have no alternative and are constrained to affirm the final judgment of the district court of December 21, 1994.

A True Copy:
Teste:

*Clerk of the United States Court of Appeals*
*for the Third Circuit*



## APPENDIX B — JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED NOVEMBER 7, 1995

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 95-1154

DAVID A. KOSS; FREYA B. KOSS,

*Appellants*

v.

UNITED STATES OF AMERICA

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 93-06965)

Present: Greenberg, Lewis and Rosenn, *Circuit Judges*

### JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel October 10, 1995.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered December 21, 1994, be, and the same is hereby affirmed. Costs taxed against the appellants. All of the above in accordance with the opinion of this Court.

*Appendix B*

Attest:

s/ P. Douglas Sisk
Clerk

Dated: November 7, 1995

Certified as a true copy and issued in lieu of a formal mandate on February 2, 1996.

Teste: s/ P. Douglas Sisk

Clerk, U.S. Court of Appeals for the Third Circuit



## APPENDIX C — MEMORANDUM AND FINAL JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA FILED DECEMBER 21, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION
NO. 93-6965

DAVID A. KOSS and FREYA B. KOSS

v.

UNITED STATES OF AMERICA

### MEMORANDUM AND FINAL JUDGMENT

HUTTON, J. December 20, 1994

Presently before the Court are defendant's Motion for Summary Judgment and Plaintiffs' opposition thereto.

### I. *BACKGROUND*

Plaintiff, David A. Koss, has been a lawyer licensed to practice in the Commonwealth of Pennsylvania since 1957. In December of 1971, plaintiff was retained by a client to perform legal services for the client pursuant to an oral agreement whereunder Koss was to be compensated from the proceeds of 50,000 shares of Video Systems Corp. stock owned by the client.

In mid-1973, a dispute acrose between plaintiff and the

client over the number of shares, proceeds from sales of which were still due to plaintiff as compensation for his legal services. On July 30, 1973, plaintiff ceased performing legal services for the client and thereafter litigation was commenced between plaintiff and the client.

In January of 1974, plaintiff and the client settled the litigation. Pursuant to the terms of the settlement, the client agreed to pay to plaintiff the proceeds from the sale thereafter of 20,000 shares and further agreed to transfer to plaintiff an additional 22,000 shares on February 1, 1974. Those 22,000 shares were restricted shares, not registered under the Securities Act of 1933 which could not be sold to the public unless certain conditions were met, as promulgated by the Securities and Exchange Commission.

In their 1974 federal income tax return, David and Freya Koss reported that as a result of the transfer of the 22,000 shares, they received gross ordinary income of $4,400.

Commencing in mid-1977, the Internal Revenue Service conducted an examination of plaintiffs' 1974 federal income tax return. While this examination was pending, plaintiffs filed, on or about April 15, 1978, a federal income tax return for the year 1977, on which return they claimed no loss with respect to the 22,000 shares of Video stock transferred in 1974.

On December 5, 1980, the Internal Revenue Service asserted an income tax deficiency against the plaintiffs for the year 1974 in the amount of $48,788.05. This deficiency was based primarily on the assertion by the Internal Revenue Service that the 22,000 shares of Video stock transferred in 1974 had a fair market value of $110,000 and not $4,400 as reported by



plaintiffs, thus increasing the gross ordinary income of plaintiffs in 1974 by $105,600.

On February 28, 1981, plaintiffs filed a timely petition in the United States Tax Court for a redetermination of the asserted deficiency for the year 1974, in which petition the plaintiffs contested the valuation placed on the shares by the Internal Revenue Service and further claimed that the fair market value of the shares as of October, 1975 should have been reported on plaintiffs' 1975 tax return. Trial took place on October 9, 1985 and thereafter, on July 11, 1989, the Tax Court adopted the position taken by the Internal Revenue Service in its determination by deciding that the basis of 22,000 shares was $110,000 and that plaintiffs erroneously omitted $110,000 from gross ordinary income on the 1974 income tax return.

On September 27, 1989, the Tax Court entered its decision upholding the tax deficiency asserted by the Internal Revenue Service in the amount of $47,788.05 for the year 1974. Thereafter, plaintiffs filed a timely appeal to the United States Court of Appeals for the Third Circuit; the Court of Appeals affirmed the decision of the Tax Court, without opinion. The decision of the Tax Court thus became final on September 23, 1990.

Thereafter, plaintiffs allegedly filed with the Internal Revenue Service, on August 3, 1991, an amended income tax return for the year 1977 in which they requested an adjustment of their income tax liability for the year 1977 due to a $110,000 loss incurred by virtue of the worthlessness of the 22,000 shares of stock which occurred in 1977, and a refund of the tax previously paid for that year in the amount of $899.07. On the same date, plaintiffs filed with the Internal Revenue Service an amended

income tax return for the year 1974, in which they requested an adjustment of their 1974 income tax liability as was finally determined by the Tax Court, which requested adjustment was based on the carryback of the net operating loss incurred in 1977 by virtue of the worthlessness of the 22,000 shares.

Plaintiffs' request for adjustment of their 1977 and 1974 income tax liabilities and for refund of the overpaid 1977 tax were disallowed by the Internal Revenue Service on November 21, 1993, on the grounds that plaintiffs' requests were not permitted by the provisions of §§ 1311-14 of the Internal Revenue Code and that said requests for adjustment were barred by the statute of limitations as contained in § 6511 of the Code.

## II. *DISCUSSION*

The statute of limitations for filing a claim for refund when a return has been filed is generally three years from the filing of the return or two years from the payment of the amount of tax at issue. Internal Revenue Code of 1986, 28 U.S.C. § 6511(a). A special provision of the Code grants an extended period for filing a refund claim arising from the worthlessness of securities such as those held by plaintiffs in this case. Under § 6511(d)(a)(A) of the Code, however, the three year statute of limitation is only extended to seven years.

Plaintiffs filed their 1977 income tax return on or before April 15, 1978 and the tax was paid as of that date. Section 6511(d)(1)(A) extends the statute of limitations to April 15, 1985. Plaintiffs did not file the claim for refund until August 3, 1991 (or September 13, 1993 according to Internal Revenue Service records). The claim is therefore time-barred.



Pursuant to §§ 1311-14 of the Code, however the effects of the statute of limitations may be mitigated. The taxpayer may, under certain circumstances, open a closed year to make a correction based on a determination, or final judgment. Section 1311(b) requires that the IRS must have taken a position inconsistent with its position during the determination, before a refund or credit could be allowed. That is, if the plaintiffs in this case had taken a loss in 1977 of $4,400 and the IRS accepted that loss although claiming that the plaintiffs' basis was $110,000 in the Tax Court litigation, then the IRS could have been said to have taken an inconsistent position with respect to the two years. *See Commissioner v. Goldstein*, 340 F.2d 24 (2d Cir. 1965). In this case, however, the plaintiffs never claimed a loss in 1977 and the IRS never took a position as to the loss in 1977, since it was never an issue until 1991. Plaintiffs here attempt to raise for the first time a worthless security loss, well beyond the statute of limitations.

Finally, plaintiffs' reliance on the "equitable recoupment" doctrine is misplaced. Equitable recoupment can only be raised to correct a closed taxable year in the context of a suit over which the court otherwise has jurisdiction. *United States v. Dalm*, 494 U.S. 596, 608 (1990). Since plaintiffs' complaint here is time-barred, this Court lacks jurisdiction and the equitable recoupment remedy is thus unavailable.

Accordingly, summary judgment is granted in favor of the defendant and against the plaintiffs.

An appropriate Order follows.

*Appendix C*

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION
NO. 93-6965

DAVID A. KOSS and FREYA B. KOSS

v.

UNITED STATES OF AMERICA

**FINAL JUDGMENT**

AND NOW, this 20th day of December, 1994, upon consideration of Defendant's Motion for Summary Judgment and Plaintiffs' opposition thereto, IT IS HEREBY ORDERED that Defendant's Motion is **GRANTED**.

IT IS FURTHER ORDERED that JUDGMENT is entered in **FAVOR** of Defendant and **AGAINST** Plaintiffs.

BY THE COURT:

s/ Herbert J. Hutton
HERBERT J. HUTTON, J.

ENTERED: 12/21/94
CLERK OF COURT



**APPENDIX D — ORDER DENYING PETITION FOR REHEARING OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED JANUARY 25, 1996**

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 95-1154

DAVID A. KOSS; FREYA B. KOSS,

*Appellants*

v.

UNITED STATES OF AMERICA

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 93-06965)

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, *Chief Judge*, and BECKER, STAPLETON, MANSMANN, GREENBERG, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS, MCKEE, SAROKIN, and ROSENN, *Circuit Judges*

The petition for rehearing filed by the appellants, David A. Koss and Freya B. Koss, in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the court in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit

*Appendix D*

judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT:

s/ Martin S. Greenberg
Circuit Judge

DATED: JAN 25 1996



## APPENDIX E — RELEVANT STATUTES

### 26 U.S.C. § 1311

### Part II. — Mitigation of Effect of Limitations and Other Provisions

**Sec. 1311. Correction of error.**

**(a) General rule.**

If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

**(b) Conditions necessary for adjustment.**

**(1) Maintenance of an inconsistent position.** Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if —

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the

determination a position maintained by the taxpayer with respect to whom the determination is made,

and the position maintained by the Secretary in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or non-recognition, as the case may be.

**(2) Correction not barred at time of erroneous action.**

(A) Determination described in section 1312(3)(B). In the case of a determination described in section 1312(3)(B) (relating to certain exclusions from income), adjustment shall be made under this part only if assessment of a deficiency for the taxable year in which the item is includible or against the related taxpayer was not barred, by any law or rule of law, at the time the Secretary first maintained, in a notice of deficiency sent pursuant to section 6212 or before the Tax Court, that the item described in section 1312(3)(B) should be included in the gross income of the taxpayer for the taxable year to which the determination relates.

(B) Determination described in section 1312(4). In the case of a determination described in section 1312(4) (relating to disallowance of certain deductions and credits), adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit described in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the



time the taxpayer first maintained before the Secretary or before the Tax Court, in writing, that he was entitled to such deduction or credit for the taxable year to which the determination relates.

**(3) Existence of relationship.** In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B)), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

**Sec. 1312. Circumstances of adjustment.**

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

**(1) Double inclusion of an item of gross income.** The determination requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

**(2) Double allowance of a deduction or credit.** The determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer.

**(3) Double exclusion of an item of gross income.**

(A) Items included in income. The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or

(B) Items not included in income. The determination requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

**(4) Double disallowance of a deduction or credit.** The determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer.

**(5) Corrective deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs.** The determination allows or disallows any of the additional deductions allowable in computing the taxable income of estates or trusts, or requires or denies any of the inclusions in the computation of taxable income of beneficiaries, heirs, or legatees, specified in subparts A to E, inclusive (secs. 641 and following, relating to estates, trusts, and beneficiaries) of part I of subchapter J of this chapter, or corresponding provisions of prior internal revenue laws, and the correlative



inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer.

**(6) Correlative deductions and credits for certain related corporations.** The determination allows or disallows a deduction (including a credit) in computing the taxable income (or, as the case may be, net income, normal tax net income, or surtax net income) of a corporation, and a correlative deduction or credit has been erroneously allowed, omitted, or disallowed, as the case may be, in respect of a related taxpayer described in section 1313(c)(7).

**(7) Basis of property after erroneous treatment of prior transaction.**

(A) General-rule. The determination determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

(B) Taxpayers with respect to whom the erroneous treatment occurred. The taxpayer with respect to whom the erroneous treatment occurred must be —

(i) the taxpayer with respect to whom the determination is made,

(ii) a taxpayer who acquired title to the property in the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, or

(iii) a taxpayer who had title to the property at the time of the transaciton and from whom, mediately, or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift).

(C) Prior erroneous treatment. With respect to a taxpayer described in subparagraph (B) of this paragraph —

(i) there was an erroneous inclusion in, or omission from, gross income,

(ii) there was an erroneous recognition, or nonrecognition, of gain or loss, or

(iii) there was an erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible.



**Sec. 1313. Definitions.**

**(a) Determination.**

For purposes of this part, the term "determination" means —

**(1)** a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;

**(2)** a closing agreement made under section 7121;

**(3)** a final disposition by the Secretary of a claim for refund. For purposes of this part, a claim for refund shall be deemed finally disposed of by the Secretary —

(A) as to items with respect to which the claim was allowed, on the date of allowance of refund or credit or on the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(B) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Secretary in reduction of the refund or credit, on expiration of the time for instituting suit with respect thereto (unless suit is instituted before the expiration of such time); or

**(4)** under regulations prescribed by the Secretary, an agreement for purposes of this part, signed by the Secretary and by any person, relating to the liability of such person (or the person for whom he acts) in respect of a tax under this subtitle for any taxable period.

*Appendix E*

**(b) Taxpayer.**

Notwithstanding section 7701(a)(14), the term "taxpayer" means any person subject to a tax under the applicable revenue law.

**(c) Related taxpayer.**

For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

**(1)** husband and wife,

**(2)** grantor and fiduciary,

**(3)** grantor and beneficiary,

**(4)** fiduciary and beneficiary, legatee, or heir,

**(5)** decedent and decedent's estate,

**(6)** partner, or

**(7)** member of an affiliated group of corporations (as defined in section 1504).



*Appendix E*

**Sec. 1314. Amount and method of adjustment.**

**(a) Ascertainment of amount of adjustment.**

In computing the amount of an adjustment under this part there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be the excess of —

**(1)** the sum of —

**(A)** the amount shown as the tax by the taxpayer on his return (determined as provided in section 6211(b)(1), (3) and (4), relating to the definition of deficiency), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

**(B)** the amounts previously assessed (or collected without assessment) as a deficiency over —

**(2)** the amount of rebates, as defined in section 6211(b)(2), made. There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212), determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts

wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

**(b) Method of adjustment.**

The adjustment authorized in section 1311(a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss or net capital loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss arises.



**(c) Adjustment unaffected by other items.**

The amount to be assessed and collected in the same manner as a deficiency , or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

**(d) Periods for which adjustment may be made.**

No adjustment shall be made under this part in respect of any taxable year beginning prior to January 1, 1932.

**(e) Taxes imposed by subtitle C.**

This part shall not apply to any tax imposed by subtitle (C) (sec. 3101 and following relating to employment taxes).

**26 U.S.C. § 1016**

**§ 1016. Adjustments to basis**

**(a) General rule.** — Proper adjustment in respect of the property shall in all cases be made —

**(1)** for expenditures, receipts, losses, or other items, properly chargeable to capital account, but no such adjustment shall be made —

**(A)** for taxes or other carrying charges described in section 266, or

*Appendix E*

**(B) for expenditures described in section 173 (relating to circulation expenditures),**

**for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years; . . .**

Supreme Court, U.S.
FILED
JUN 28 1996
CLERK

(2)

No. 95-1784

# In the Supreme Court of the United States

OCTOBER TERM, 1995

DAVID A. KOSS AND FREYA B. KOSS, PETITIONERS

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
*Solicitor General*
LORETTA C. ARGRETT
*Assistant Attorney General*
KENNETH L. GREENE
SARA ANN KETCHUM
*Attorneys*
*Department of Justice*
*Washington, D.C. 20530*
*(202) 514-2217*

HPP

## QUESTION PRESENTED

Whether petitioners satisfied the requirements for application of the mitigation provisions of the Internal Revenue Code, 26 U.S.C. 1311-1314.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Statement | 2 |
| Discussion | 5 |
| Conclusion | 11 |


## TABLE OF AUTHORITIES


Cases:

| | |
|---|---|
| *Chertkof* v. *United States*, 676 F.2d 984 (4th Cir. 1982) | 9, 10 |
| *Flora* v. *United States*, 362 U.S. 145 (1960) | 4 |
| *Koss* v. *Commissioner*, 57 T.C.M. (CCH) 882 (1989), aff'd, 908 F.2d 962 (3d Cir. 1990) | 2 |
| *O'Brien* v. *United States*, 766 F.2d 1038 (7th Cir. 1985) | 6 |
| *United States* v. *Rushlight*, 291 F.2d 508 (9th Cir. 1961) | 8, 9 |

Statutes:

Internal Revenue Code (26 U.S.C.):

| | |
|---|---|
| §§ 1311-1314 | 3 |
| § 1311(a) | 5 |
| § 1311(b)(1) | 4, 6, 7, 10 |
| § 1312 | 5 |
| § 1312(7) | 6, 9 |
| § 1312(7)(A) | 4, 6, 8, 10 |
| § 1312(7)(C) | 6 |
| § 1313(a)(1) | 5 |
| § 6511 | 3, 4, 5 |
| § 6511(d)(2)(A) | 4 |
| § 6512(a) | 4 |
| § 7481(a)(2)(A) | 2 |

# In the Supreme Court of the United States

OCTOBER TERM, 1995

---

No. 95-1784

DAVID A. KOSS AND FREYA B. KOSS, PETITIONERS

*v.*

UNITED STATES OF AMERICA

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

---

## BRIEF FOR THE UNITED STATES IN OPPOSITION

---

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 69 F.3d 705. The opinion of the district court (Pet. App. 21a-25a) is unreported.

### JURISDICTION

The judgment of the court of appeals was entered on November 7, 1995. Pet. App. 19a-20a. A petition for rehearing was denied on January 25, 1996. Pet. App. 27a. The petition for a writ of certiorari was filed on April 24, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. In 1974, petitioner David Koss received 22,000 shares of Video Systems Corporation stock from a client in settlement of a dispute over compensation for legal services. Petitioners David and Freya Koss reported the transfer of the 22,000 shares as ordinary income in the amount of $4,400 on their joint income tax return for 1974. In 1977, the Internal Revenue Service commenced an examination of that return (Pet. App. 2a-3a, 22a).

On December 5, 1980, the Service issued a notice of deficiency with respect to petitioners' 1974 return. The deficiency was based on the determination that the fair market value of the stock received in 1974 was $110,000 rather than the $4,400 stated on the return. Petitioners sought review of the asserted deficiency in the Tax Court (Pet. App. 3a, 23a).

The Tax Court upheld the deficiency, concluding that the stock that petitioner received in 1974 had a fair market value of $110,000 in that year (Pet. App. 3a, 23a). The Third Circuit affirmed. *Koss* v. *Commissioner*, 57 T.C.M. (CCH) 882 (1989), aff'd, 908 F.2d 962 (3d Cir. 1990). That decision became final on September 23, 1990, when the time for filing a petition for a writ of certiorari expired (Pet. App. 3a, 23a). See 26 U.S.C. 7481(a)(2)(A).

2. The 1977 income tax return filed by petitioners made no claim of any sort with respect to the stock received by petitioners in 1974. On August 3, 1991, however, petitioners amended their income tax returns for 1977 and 1974 to assert that the stock they received in 1974 became worthless in 1977. The amended returns claimed that the loss from the worthless stock was greater than petitioners' reported income for 1977 and therefore resulted in zero tax liability for petitioners for that year. Petitioners therefore requested a refund of the taxes they paid for 1977. They also sought to carry back the excess loss to 1974 and requested an adjustment of the taxes determined by the Tax Court for that year (Pet. App. 3a-4a, 23a-24a). With the amended return, petitioners paid a tax of $2,148 for 1974, which they computed was the amount due after application of the carryback loss (*id.* at 4a).



The Service disallowed the requested adjustments. Petitioners then filed this refund suit (Pet. App. 4a, 24a).

3. The district court noted that petitioners' 1991 refund claim for 1977 taxes was filed long after it was barred by the statute of limitations in 26 U.S.C. 6511. The court therefore awarded summary judgment to the government (Pet. App. 24a-25a).

The court rejected petitioners' argument that the mitigation provisions of 26 U.S.C. 1311-1314 permit the untimely suit to proceed. The court held that those provisions are inapplicable because the Service had not taken any inconsistent position in making its determinations of petitioners' tax liabilities (Pet. App. 25a). Petitioners did not claim any loss on their 1977 return with respect to the stock. The Service thus took no position at all regarding the basis of the stock in 1977—and necessarily took no position that was inconsistent with the determination made by the Service with respect to the value of that stock in 1974 (*ibid.*).[1]

---

[1] The district court also rejected petitioners' assertion that they were entitled to relief under the doctrine of equitable

4. The court of appeals affirmed (Pet. App. 1a-20a). The court agreed that the refund claim for 1977 had long been barred by the statute of limitations in 26 U.S.C. 6511 (Pet. App. 5a-6a). The court further held that the refund claim for 1974 was, in addition, precluded (i) by petitioners' failure to pay the full tax owed before bringing suit, as required by *Flora* v. *United States*, 362 U.S. 145, 177 (1960) (Pet. App. 6a); (ii) by the alternative statute of limitations applicable to carrybacks of net operating losses in 26 U.S.C. 6511(d)(2)(A) (Pet. App. 7a); and (iii) by 26 U.S.C. 6512(a), which bars a refund suit for the same tax year for which the taxpayer previously filed a petition in Tax Court (Pet. App. 7a-8a).

The court rejected petitioners' contention that the mitigation provisions of the Internal Revenue Code permit their untimely suit to proceed. The court stated that petitioners' suit did not invoke the mitigation provisions because the error they sought to correct—their failure to report a loss in 1977—did not occur "in respect of any transaction on which such basis depends," as required by 26 U.S.C. 1312(7)(A) (Pet. App. 13a).

The court further held that, even had the suit satisfied the requirements of 26 U.S.C. 1312(7)(A), it would still be barred because it failed to satisfy the requirement in 26 U.S.C. 1311(b)(1) that the Service maintain a position (for 1977) that is inconsistent with its prior determination (for 1974). The court explained that, since petitioners did not declare any loss with respect to the stock on their 1977 return, the IRS could not have taken any position concerning

---

recoupment (Pet. App. 25a). The court of appeals upheld that ruling (*id.* at 17a), which is not addressed in the petition.



that stock in 1977 and thus could not have taken a position inconsistent with its position in the Tax Court litigation (Pet. App. 16a).

## DISCUSSION

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Petitioners filed their claims for refund long after the time for such claims had expired pursuant to 26 U.S.C. 6511. See Pet. App. 5a. Petitioners sought to overcome the statute of limitations by resort to the "mitigation" provisions of the Internal Revenue Code, which allow for corrections of errors that would otherwise be "prevented by the operation of any law or rule of law." 26 U.S.C. 1311(a). The court of appeals correctly held (Pet. App. 16a) that the statutory prerequisites for application of the mitigation provisions are not satisfied in this case.

The Code imposes numerous prerequisites for application of the mitigation provisions. First, there must be a "determination" which, as defined by statute, includes (as is relevant here) a Tax Court decision that has become final. 26 U.S.C. 1313(a)(1). Second, the "determination" must be one of the seven specified "circumstances of adjustment" described in 26 U.S.C. 1312. 26 U.S.C. 1311(a). Third, the correction of the error in the year that is the subject of the suit must, at the time of the determination, be "prevented by operation of any law or rule of law." *Ibid.* Fourth, the party against whom the mitigation provisions are being invoked (in this case, the Commissioner) must have maintained a position with respect to the determination involved in the current

suit that is inconsistent with the treatment of that same item in a closed year. 26 U.S.C. 1311(b)(1).

The court of appeals correctly rejected petitioners' contention that the proposed correction of their tax liability for 1977 falls within the "circumstances of adjustment" described in Section 1312(7) of the Code. Section 1312(7) concerns the correction of errors with respect to the basis of property. To qualify for relief under Section 1312(7), petitioners were required to demonstrate the existence of four conditions: (i) that there was a prior determination of the basis of the property;[2] (ii) that there is a "transaction on which such basis depends or * * * [a] transaction which was erroneously treated as affecting such basis"; (iii) that, "in respect of" that transaction, there occurred an error listed in Section 1312(7)(C);[3] and (iv) that the error occurred with respect to "the taxpayer with respect to whom the determination was made." 26 U.S.C. 1312(7)(B); see *O'Brien* v. *United States*, 766 F.2d 1038, 1042 (7th Cir. 1985).

Petitioners do not meet the third requirement. As the court of appeals correctly held, petitioners' claim for relief under the mitigation provisions fails, among other reasons, because (Pet. App. 11a-12a):

---

[2] That requirement is met in this case by the prior decision of the Tax Court that the property had a value of $110,000 when it was received in 1974.

[3] The errors listed in Section 1312(7)(C) are: (i) "erroneous inclusion in, or omission from, gross income," (ii) "erroneous recognition, or nonrecognition, of gain or loss," and (iii) "erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible." Petitioners contend that there was an erroneous nonrecognition of loss in 1977 when the Video stock allegedly became worthless (Pet. App. 11a).



> the error they specify was not due to the determination by the Tax Court of the 1974 basis of the shares. The nonrecognition in the 1977 return of the loss of the value of the shares was caused by the [petitioners'] failure to declare that they had any loss at all.

The court thus correctly concluded that the requisite causal connection between the determination of basis in 1974 and the nonrecognition of loss in 1977 did not exist.

The court of appeals observed that, even if there was some causal factor between the determination of basis and the nonrecognition of loss if and when the stock became worthless in 1977 (Pet. App. 13a):

> the error alleged here, the nonrecognition of loss resulting from the worthlessness of the stock in 1977, similarly was not "in respect of any transaction on which such basis depends." 26 U.S.C. § 1312(7)(A). The basis of the shares in the determination depended on the transaction in which [petitioner] acquired them in 1974. The basis of the shares did not depend on their becoming worthless in 1977. Thus, the error in failing to recognize the shares' loss in value did not occur "in respect of" their acquisition by [petitioner] in 1974.

As the court of appeals correctly stated, the Service did not assert inconsistent positions, as required by 26 U.S.C. 1311(b)(1) (Pet. App. 15a-16a). In the Tax Court litigation, the Service took the position that petitioners undervalued the Video stock *at the time it was received, in 1974*, and contended that the fair market value of the stock *in that year* was $110,000, rather than $4,400 as reported by

petitioners. The Tax Court agreed with the Service's position. Nothing in that decision addressed what value, if any, the stock had in 1977—the year that petitioners now belatedly claim that the stock became worthless.

In short, the conclusion that the stock was worth $110,000 in 1974 is not inconsistent with *any* conclusion as to the value of that stock in 1977. The fact that petitioners failed to claim a loss for the alleged worthlessness of the stock in 1977 is entirely independent of the prior determination of the value of that stock in 1974.

2. a. Petitioners contend (Pet. 6-7) that the decision in this case conflicts with *United States* v. *Rushlight*, 291 F.2d 508 (9th Cir. 1961). Petitioners claim that *Rushlight* stands for the proposition that the requirement of Section 1312(7)(A) that the error to be corrected must be "in respect of" the "transaction on which * * * basis depends" is satisfied when "the disposition transaction is also a transaction on which the basis of property depends" (Pet. 6).

In *Rushlight*, the taxpayers were partners of a partnership that owned certain steel mill equipment. The partnership claimed to have abandoned that equipment in 1945 and claimed a deduction for an abandonment loss in that year. If that deduction were valid, the basis of the steel mill equipment would be reduced to zero. The Service determined, however, that the equipment had not been abandoned. That determination was subsequently upheld by the Tax Court. In the interim, however, the taxpayers had taken possession of the equipment, sold it, and reported capital gains based upon an adjusted basis of zero. After the Tax Court upheld the Service's



determination, the taxpayers claimed that they had erroneously reported the capital gains because the basis in the equipment, as determined by the Tax Court, exceeded the sale proceeds. 291 F.2d at 511-512. The court held in *Rushlight* that the taxpayers were entitled to relief under the predecessor of Section 1312(7) because "a determination of basis at the time of disposition of the property can properly be said to be 'in respect of any transaction upon which such basis depends,' i. e. the transaction referred to is the transaction in which the property was acquired, and the basis of the property at the time of disposition can be said to depend on such transaction." 291 F.2d at 516.[4]

In the present case, by contrast, the claimed error —the nonrecognition of loss in 1977 when the stock became worthless in that year—had no relationship to the determination of the basis of the stock in any other year. Petitioners simply failed to claim *any* loss in 1977 with respect to the stock. This failure alone led to the nonrecognition of the belatedly asserted loss.

b. Petitioners also contend (Pet. 7) that the decision in this case conflicts with *Chertkof* v. *United States*, 676 F.2d 984 (4th Cir. 1982), although they do not explain the nature of the conflict. In *Chertkof*, the taxpayers reported gains from sales of inherited stock using the basis of the shares as reported on the

---

[4] Petitioners err in asserting that *Rushlight* holds that the disposition transaction is the basis determining transaction. Instead, as the court also held in the present case (Pet. App. 12a), the *Rushlight* court held that the transaction upon which basis depends is the "transaction in which the property was acquired." 291 F.2d at 516.

estate tax return. *Id.* at 986. In a subsequent suit involving the estate, the Tax Court determined greater values for the shares than the estate had reported. *Id.* at 985-986. The taxpayers then sought refunds of the income taxes paid on the gains they reported from disposition of the stock. The court held that the sales of stock did not qualify under the mitigation provisions as "transaction[s] on which such basis depends," as required by Section 1312(7)(A), but were only "transactions which depend on basis." 676 F.2d at 992. The court allowed relief only on the separate ground that the acquisition of the stock by inheritance constituted a basis-determining transaction. That rationale obviously has no application to the present case. *Id.* at 993.

3. Finally, petitioners assert (Pet. 9) that the court of appeals erred in this case by holding that the requirement of inconsistent treatment that is imposed by Section 1311(b)(1) is met only if there is an "active" inconsistency on the part of the IRS. The court of appeals did not, however, adopt an "active" inconsistency standard. Instead, the court held that, because petitioners failed to claim *any* loss whatsoever for the alleged worthlessness of the stock on their 1977 return, the Service simply took *no* position —certainly not an inconsistent position—on the value of the stock in that year. As the court summarized (Pet. App. 16a):

> [T]he IRS accepted their 1977 return without notice that the shares were worthless. Surely, the IRS is not required to verify the value of the capital assets of all taxpayers each year to make sure they have not become worthless. Thus, its acceptance of the 1977 return that did not declare



> such a loss, at whatever value, is not inconsistent with its successful position in Tax Court that the shares had a basis of $110,000 to the [petitioners] in 1974.

The court concluded that "the IRS could not have maintained inconsistent positions because when [petitioners] filed their 1977 return they did not declare that the shares became worthless in that year and, thus, they did not put the IRS on notice of that fact" (*ibid.*).

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
*Solicitor General*
LORETTA C. ARGRETT
*Assistant Attorney General*
KENNETH L. GREENE
SARA ANN KETCHUM
*Attorneys*

JUNE 1996

(3)

Supreme Court, U.S.
FILED
JUL 11 1996
CLERK

No. 95-1784

In The

# Supreme Court of the United States

October Term, 1995

DAVID A. KOSS; FREYA B. KOSS,

*Petitioners,*

*vs.*

UNITED STATES OF AMERICA,

*Respondent.*

*On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit*

## REPLY BRIEF FOR PETITIONERS

FREYA B. KOSS, *Pro Se*
DAVID A. KOSS, *Pro Se*
300 East Lancaster Avenue
Suite 202
Wynnewood, Pennsylvania 19096
(610) 642-2025

8634
Lutz Appellate Services, inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

10 pp

## TABLE OF CONTENTS


| | Page |
|---|---|
| Discussion | 1 |


## TABLE OF CITATIONS

**Cases Cited:**


| | |
|---|---|
| *Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982) | 4 |
| *Malat v. Riddell*, 383 U.S. 569 (1965) | 3 |
| *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985) | 2, 4, 5 |
| *United States v. Rushlight*, 291 F.2d 508 (9th Cir. 1961) | 3, 4, 6 |


**Statutes Cited:**


| | |
|---|---|
| 26 U.S.C. § 1016(a)(1) | 2, 3 |
| 26 U.S.C. § 1311 | 1 |
| 26 U.S.C. § 1311(b)(1) | 1, 5, 6 |
| 26 U.S.C. § 1312 | 1 |
| 26 U.S.C. § 1312(7) | 1 |
| 26 U.S.C. § 1312(7)(A) | 1, 2, 3 |

*Contents*


| | *Page* |
|---|---|
| 26 U.S.C. § 1312(7)(C) | 4 |
| 26 U.S.C. § 1313 | 1 |
| 26 U.S.C. § 1314 | 1 |
| **Other Authority Cited:** | |
| Treasury Regulation § 1.165-1(c) | 3 |




## DISCUSSION

Respondent's contentions (Br. 5-8), that petitioners are not entitled to the benefit of the mitigation provisions of the Internal Revenue Code, 26 U.S.C. §§ 1311-1314, because petitioners did not meet the requirements of §§ 1312(7)(A) and 1311(b)(1), are incorrect.

1. With respect to § 1312(7)(A), respondent and the circuit court of appeals, in order to come to their conclusions that petitioners have not met the requirements of this section, have misinterpreted certain words contained in this section and, more importantly, have misinterpreted and changed another word and replaced that word with a word having a meaning different from the word contained in this section.

Initially, respondent and the circuit court failed to differentiate the meaning of the phrase "in respect of" from the phrase "with respect to," both of which phrases appear in the section. The former phrase is used each time in the section in connection with the words "any transaction," whereas the latter phrase is used in the section, and throughout other paragraphs of § 1312(7), in connection with the words " a taxpayer" or the word "whom." It is submitted that the phrase " in respect of" is used to describe a relation to one of many possible transactions on which basis of property depends, whereas the phrase "with respect to" is used to describe a relation to only one, specific taxpayer. It is submitted that if Congress had intended both phrases to describe a relation to only one, specific transaction or to one, specific taxpayer, it would have used the very same phrase in the section in all instances and would not have used two different phrases. Congress used the phrase "in respect of" because, contrary to the contention of respondent and the circuit court, Congress knew that there are many transactions which occur and on which basis of property depends and that a

transaction in which property is acquired is not the only transaction on which the basis of property depends.

More importantly, respondent interprets and changes the word "any" as is contained in § 1312(7)(A) to the word "that" (Br. 6) or to the word "the" (Br. 8), as did the circuit court, in the phrase ". . . and in respect of any transaction on which such basis depends. . . ." These changes are uncalled for and patently incorrect. The ordinary meaning of the word "any," as defined in any dictionary, is " one of more than two" or "one of many." Thus, the section contemplates that there are various, and certainly more that one, transactions on which the basis of property depends, whereas the words "that" and "the" limit the required transaction to only one such possible transaction. The replacement of the word "any" with the words "that" or "the" by the respondent and the circuit court in the instant matter and the circuit court in the case of *O'Brien v. United States*, 766 F.2d 1038, 1042 (7th Cir. 1985), caused the respondent and the circuit court in the instant matter and the circuit court in *O'Brien* to erroneously conclude that there is only one transaction on which basis depends and in which the error to be corrected must occur.

If Congress believed that there is only one transaction on which the basis of property depends and intended to delineate that one transaction as being the transaction in which the property was acquired, as is the contention of the respondent and the circuit court, it could have delineated that transaction in the statute or utilized words in the statute to accomplish this belief and intention. Congress did not do so because it recognized that transactions other than the acquisition transaction influence and determine the basis of property. Such other transactions are those in which the Internal Revenue Code requires that adjustments be made to the original basis of the property, including transactions involving expenditures, receipts, losses or other items properly chargeable to the property, all as is set forth in § 1016(a)(1) of the



Internal Revenue Code, 26 U.S.C. § 1016(a)(1) and Treasury Regulation 1.165-1(c).

The respondent and the circuit court in the instant matter failed to recognize that worthlessness of stock is a transaction on which basis depends because § 1016(a)(1) of the Code requires that the basis of the stock be reduced by the amount of the loss incurred as a result of such worthlessness. The failure of petitioners to recognize the loss on their 1977 tax return is, it is submitted, exactly the type of error which the mitigation provisions of the Code were enacted to permit a taxpayer to correct because the error occurred in a transaction on which basis depends. Respondent's contention, that § 1312(7)(A) does not apply in the instant matter because petitioners took no loss whatever in 1977 and because the Tax Court in 1990 only determined the basis of the stock in 1974 (Br. 7), is without foundation in law. Rather, these facts squarely fit the requirements of § 1312(7)(A).

The words of a statute are to be given their ordinary meaning, unless a contrary intention appears from the words of the statute. *Malat v. Riddell*, 383 U.S. 569 (1965). No such contrary intent appears from the words of the statute in question. The respondent and the circuit court failed to give the words contained in the statute their ordinary meaning and by failing to do so they have incorrectly changed the meaning of § 1312(7)(A) from that meaning intended by Congress.

2. Respondent's contention that the decision of the court of appeals in the instant matter is not in conflict with the decisions of other circuit courts of appeals is incorrect, because respondent has misinterpreted the facts and decisions of the conflicting circuits.

In the cases of *United States v. Rushlight*, 291 F.2d 508 (9th

Cir. 1961); *Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982); *O'Brien v. United States, supra*, and in the instant matter, the taxpayer attempted to invoke the mitigation provisions of the Internal Revenue Code, in order to correct an error made by the taxpayer, which error occurred in the transaction in which the property was disposed of. In none of the cases did the taxpayer seek to correct an error made in the transaction in which the property was acquired. In each case, the year in which the property was disposed of was closed by the statute of limitations.

In each case a determination of the basis of the property had been made in a year subsequent to the year in which the property was disposed of, but for a year prior to the year in which the property was disposed of. In each case, the determination adopted the position of the Internal Revenue Service as to the basis of the property to the taxpayer for a year prior to the year in which the property was disposed of.

In the three cited cases, the taxpayer, in the disposition transaction, erroneously recognized gain, which error was attributable to the increase in the basis of the property as a result of the subsequent determination. In the instant matter, the taxpayer, in the disposition transaction, erroneously failed to recognize a loss in the amount of $105,600, which error was attributable to the increase in the basis of the stock as a result of the subsequent determination. Both the recognition of gain and the nonrecognition of loss are types of errors which may be corrected under §1312(7)(C) of the Code.

Notwithstanding that the above facts existed in all of the cases, the circuit courts in *Rushlight* and *Chertkof* concluded that the mitigation provisions applied and permitted correction of the error made by the taxpayer in the disposition transaction. However, the circuit courts in *O'Brien* and the instant matter refused to permit the taxpayer to invoke the mitigation



provisions of the Code on the ground set forth in *O'Brien*, that the only transaction on which basis depends is the transaction in which the property was acquired and that only an error made in that acquisition transaction can be corrected. It is submitted that the decisions of the *O'Brien* court and the court in the instant matter are in error and result from those errors made by the courts as set forth in 1. above and 3. below.

3. With respect to § 1311(b)(1), respondent and the circuit court of appeals, in order to come to their conclusions that petitioners have not met the requirements of this section, have failed to give certain words, as contained in this section, their ordinary, clear and explicit sense and have replaced said words with words embodying requirements which are not contained in this section and which requirements are contrary to the explicit words contained in said section.

The respondent and the circuit court, in interpreting the words:

> . . . and the position maintained by the Secretary . . . is inconsistent with the erroneous . . . nonrecognition. . . .

26 U.S.C. § 1311(b)(1), failed to give the words "erroneous nonrecognition" their ordinary, clear and explicit sense. These words clearly mean the erroneous failure to disclose, or failure to identify, or failure to acknowledge [a loss]. The words "erroneous nonrecognition" were simply read out of this section by the respondent and the circuit court.

In place of the words "erroneous nonrecognition", the respondent and the circuit court inserted a requirement that the position maintained by the Secretary (in the proceeding in which basis is determined) must be inconsistent with the position

maintained by the Secretary in the year of the error, or inconsistent with the treatment of the error by the Secretary. Such is not what the statute requires. The plain words of the statute require that the position maintained by the Secretary (in the proceeding in which basis is determined) must be inconsistent with the error of the taxpayer. *United States v. Rushlight, supra* at 518. The statute nowhere requires that the position maintained by the Secretary (in the proceeding in which basis is determined) must be inconsistent with any position maintained by the Secretary in the year of the error, or inconsistent with any treatment of the error by the Secretary.

In the instant matter, the Secretary maintained a position in the prior proceeding in which basis was determined that the Video stock had a basis to the petitioners of $110,000. The petitioners claimed that the basis of the stock was $4,400 and reported the latter amount as ordinary income on their 1974 tax return. In the determination proceeding, the Tax Court adopted the position of the Secretary and determined that the basis of the stock was $110,000, which determination took place in 1990. In 1977, the year in which the petitioners claim that the stock became worthless, they failed to take the loss then known to them in the amount of $4,400 because, as the record shows, they had no income tax to pay in 1977 even without the loss. Thus, the error of the petitioners in 1977 was the nonrecognition of loss in the amount of $105,600, which error was inconsistent with the position maintained by the Secretary in the determination proceeding that the stock had a basis of $110,000. The fact that the Internal Revenue Service had no notice of the loss in any amount is irrelevant to the requirement of inconsistency as required by the plain words of § 1311(b)(1) of the Code. The fact is that petitioners filed a tax return in 1977 which contained an error of nonrecognition of a loss due solely to the basis determination which occurred in 1990, which nonrecognition of loss was inconsistent with the position maintained by the Secretary, and adopted, in the determination proceeding.



## CONCLUSION

For the reasons set forth above and for the reasons set forth in petitioners' petition for writ of certiorari, petitioners respectfully request that this Court grant the petition for writ of certiorari.

Respectfully submitted,

FREYA B. KOSS, *Pro Se*
DAVID A. KOSS, *Pro Se*
300 East Lancaster Avenue
Suite 202
Wynnewood, Pennsylvania 19096
(610) 642-2025